

SERVICE DATE - JANUARY 21, 2003

SURFACE TRANSPORTATION BOARD

DECISION

STB Finance Docket No. 34177

IOWA, CHICAGO & EASTERN RAILROAD CORPORATION—ACQUISITION
AND OPERATION EXEMPTION—LINES OF I&M RAIL LINK, LLC

Decided: January 17, 2003

By decision served July 22, 2002 (Stay Decision), the Board removed the temporary housekeeping stay issued in this proceeding and denied requests to stay the effectiveness of this acquisition exemption. The Board also indicated that it would address pending petitions to revoke the exemption in a subsequent decision or decisions. In this decision, we are denying the petitions to revoke.

BACKGROUND

As explained in more detail in Stay Decision, slip op. at 1, on June 7, 2002, Iowa, Chicago & Eastern Railroad Corporation (IC&E) filed a verified notice of exemption under our class exemption at 49 CFR 1150.31 to acquire and operate the rail lines and assets of I&M Rail Link, LLC (IMRL), a Class II carrier.¹ In its filing, IC&E indicated that, at that time, it was a noncarrier subsidiary of Cedar American Rail Holdings, Inc. (Holdings), a noncarrier and wholly owned subsidiary of Dakota, Minnesota & Eastern Railroad Corporation (DME).² IC&E also indicated that DME and Holdings

¹ IC&E's notice was filed pursuant to our class exemption from the prior approval requirements of 49 U.S.C. 10901 for rail line acquisitions by a noncarrier that will become a Class I or Class II carrier as a result of the acquisition. IC&E's notice of exemption was served June 12, 2002, and published June 17, 2002, at 67 FR 41297. By letter filed August 7, 2002, IC&E notified the Board that it consummated its acquisition of IMRL's rail assets on July 29, 2002, and commenced rail operations on July 30, 2002. IC&E indicates that it is now a Class II railroad.

² DME is a Class II railroad currently operating a 1,100-mile rail system in Minnesota, South Dakota, Nebraska, and Iowa. In a decision served January 30, 2002, in Dakota, Minnesota & Eastern Railroad Corporation Construction Into The Powder River Basin, STB Finance Docket No. 33407, the Board gave DME final approval, subject to a number of environmental mitigation conditions, to construct a new 262-mile rail line into Wyoming's Powder River Basin. Judicial review

(continued...)

would file an application to continue in control of IC&E soon after IC&E acquired the IMRL lines and became a rail carrier.³

On June 13, 2002, the Brotherhood of Locomotive Engineers, the Brotherhood of Maintenance of Way Employees, the Brotherhood of Railroad Signalmen, the International Association of Machinists, the International Brotherhood of Electrical Workers, and the Transportation Communications International Union (collectively referred to as Cooperating Labor Organizations or CLO) jointly filed a petition for stay (CLO-1) and a petition to revoke (CLO-2) the use of the class exemption for this transaction. Finding that petitioners had failed to demonstrate why IC&E should not be allowed to proceed under our exemption procedure, we removed the housekeeping stay previously imposed in this proceeding⁴ and denied the requests to stay the effectiveness of IC&E's exemption in Stay Decision.⁵

Petitions to revoke. In the CLO-2 petition to revoke the exemption, CLO argues that controlling precedent requires that DME be considered the purchaser of IMRL and that, as a matter of law, we should require DME to join as a party to IC&E's acquisition transaction. Asserting that DME

²(...continued)
of that decision is pending in the United States Court of Appeals for the Eighth Circuit in No. 02-1359, et al., Mid States Coalition For Progress, et al. v. STB and United States.

³ DME, Holdings, and IC&E filed an application on August 29, 2002, seeking approval under 49 U.S.C. 11321-26 for DME's acquisition of indirect control of IC&E through ownership of IC&E's stock by Holdings, in STB Finance Docket No. 34178, Dakota, Minnesota & Eastern Railroad Corporation and Cedar American Rail Holdings, Inc. – Control – Iowa, Chicago & Eastern Railroad Corporation. Under the Board's procedural schedule in that proceeding, a final decision is expected in January 2003.

⁴ See the Chairman's order served June 26, 2002 that imposed a housekeeping stay of the effectiveness of the exemption in this proceeding until July 26, 2002, pending a Board decision on the merits of the stay requests.

⁵ On July 16, 2002, CLO filed a motion for an order compelling discovery (CLO-3), a supplement to the petition for stay and opposition to the motion to lift stay (CLO-4), and a motion for extension of time in which to supplement the petition to revoke (CLO-5). We considered CLO-4 along with the CLO-1 petition for stay and the Iowa Department of Transportation's stay request filed June 14, 2002. We subsequently denied the CLO-3 motion to compel and granted the CLO-5 request for extension to supplement the petition to revoke in a decision served September 12, 2002.

is acquiring all of an existing rail carrier, CLO maintains that the acquisition of IMRL is subject to the requirements of 49 U.S.C. 11323, which governs the acquisition of one carrier by another carrier, and not 49 U.S.C. 10901. Moreover, CLO contends that IC&E is not sufficiently independent of DME to be entitled to use the class exemption procedure and that IC&E's notice of exemption is thus void ab initio pursuant to our rules at 49 CFR 1150.32(c).

In a supplement (CLO-6) filed September 26, 2002, CLO asserts that it has uncovered through discovery evidence that IC&E is not financially independent but is inextricably reliant on financial guarantees and operational support provided by both Holdings and DME. In regard to its supplemental evidence, CLO argues that IC&E is not independent of DME because IC&E shares the same executive management with DME; DME and Holdings have guaranteed all of IC&E's financial obligations; and DME exercises significant management and operational control over IC&E. CLO argues that DME's guarantee of IC&E debt goes beyond permissible start-up financing because the parent's obligation to IC&E includes a revolving credit facility and because both entities, as well as Holdings, have pledged all of their assets to secure the obligations of the other. According to CLO, in overseeing the terms of employment and hiring of IC&E employees, DME has created an integrated personnel scheme for both entities.

Arkansas Electric Cooperative Corporation (AEC) also filed a petition to revoke IC&E's exemption. AEC contends that the exemption is void ab initio because IC&E's assertion in its verified notice of exemption that, to maintain IMRL's existing service levels and gain access to the Chicago terminal, "IC&E will acquire trackage rights over the Commuter Rail Division of the Regional Transportation Authority of Northeastern Illinois, d/b/a Metra," is a material misrepresentation. According to AEC, IC&E subsequently disclosed that it has had difficulties reaching an agreement with Metra and that it was unable to acquire trackage rights over all of the Metra lines previously served by IMRL. AEC also contends that IC&E misrepresented IMRL's financial condition to bolster its argument regarding the need for a closing date for this transaction prior to the end of July.

Notwithstanding these arguments, AEC specifically states that its interest in IC&E's acquisition of IMRL "arises out of its support for competitive rail options for the movement of PRB [Powder River Basin] coal." AEC's concern here appears to be that DME's control of IC&E and eventual movement of PRB coal could adversely affect AEC's plans for an alternative routing for PRB coal.

Reply by IC&E. In its reply,⁶ IC&E notes that CLO does not challenge its evidence regarding a key element of the "alter ego" test used to determine if a transaction comes within section

⁶ IC&E seeks leave to late-file its reply 5 days after the due date specified at 49 CFR 1121.2. IC&E indicates that CLO's counsel does not object to the request. The request will be granted.

10901: IC&E's showing that it was created for substantial and legitimate business purposes and not for the sole purpose of avoiding labor protection. According to IC&E, CLO focuses solely on certain start-up debt guarantees and shared management functions that the Board has already found do not detract from IC&E's financial and operational independence. IC&E indicates in this regard that DME and IC&E maintain independent work forces and personnel schemes and that, while DME has guaranteed IC&E's start-up financing and debt, ICE will fulfill its common carrier obligation by conducting train operations in its own name and by setting its own rates, and is solely responsible for any resulting profits or losses.

With regard to AEC, IC&E asserts that petitioner's arguments related to Metra and IMRL's financial condition should have been made earlier and, in any event, are entirely irrelevant to IC&E's acquisition of IMRL. IC&E states that it has misrepresented nothing with respect to its transaction and that AEC's interest in an alternative routing for PRB coal relates only to DME's pending control proceeding, which is not involved here.

DISCUSSION AND CONCLUSIONS

Under 49 U.S.C. 10502(d), an exemption may be revoked, in whole or in part, when application of the Board's regulation is necessary to carry out the rail transportation policy of 49 U.S.C. 10101. The burden of proof is on the petitioner, who must articulate reasonable, specific concerns under the revocation criteria. Portland & Western Railroad, Inc.—Lease and Operation Exemption—Lines of Burlington Northern Railroad Company, STB Finance Docket No. 32766 (STB served Oct. 15, 1997). Labor interests have standing to question the appropriate level of labor protection in a petition to revoke. See 49 U.S.C. 10502(g); Simmons v. ICC, 900 F.2d 1023 (7th Cir. 1990).

In finding IC&E's formation properly to come under our class exemption from the prior approval requirements of section 10901 in Stay Decision, slip op. at 11, we recognized that the entity was created to insulate DME from the financial risk associated with a troubled rail operation that has changed hands three times in 15 years. CLO does not challenge IC&E's evidence that it was formed for substantial and legitimate business purposes and not for the sole purpose of avoiding labor protection. Instead, CLO has focused on certain start-up debt guarantees and shared management functions, a number of which we have already found do not detract from IC&E's financial and operational independence. See Stay Decision, slip op. at 11, in which we found that arrangements such as those between DME and IC&E "are common among affiliated carriers and do not detract from the financial and operational independence of subsidiary carriers such as IC&E."

Under the “alter ego” test, the Board considers: (1) whether the noncarrier subsidiary was created to purchase the line for legitimate and substantial business reasons (e.g., insulation from financial risk, preservation of service, or time constraints) and not solely to avoid labor protection; and (2) whether the indicia of independence establish that the noncarrier subsidiary is sufficiently independent of its parent or affiliated carriers. Mountain Laurel Railroad Company—Acquisition and Operation Exemption—Consolidated Rail Corporation, STB Finance Docket No. 31974 (STB served May 15, 1998) (Mountain Laurel). Every application of this test is fact-specific and must be considered solely within the context of the transaction at issue. Ultimately, the Board’s objective in applying the “indicia of independence” aspect of the test — which is the essential subject of CLO’s concerns — is to ensure that the two companies are not so intertwined so as to be properly considered a single entity.

In numerous cases applying this test, the Board and its predecessor, the Interstate Commerce Commission (ICC), have stated that the parents and affiliates of acquiring noncarrier subsidiaries can offer financial support without compromising their financial independence. Indeed, the ICC found that it was “customary” for parents to supply money for start-up expenses and initial capital as well as specific loan guarantees. Willamette & Pacific Railroad, Inc.—Lease and Operation Exemption—Southern Pacific Transportation Company, Finance Docket No. 32245 et al. (ICC served Sept. 7, 1995) (Willamette), slip op. at 9.⁷ The ICC recognized that new noncarrier entities may have difficulty obtaining independent financing and that loan guarantees from corporate affiliates are less costly and more secure than outside financing. Willamette. To establish its independence, the ICC stated that the

⁷ See also Akron Barberton Cluster Railway Company—Acquisition and Operation Exemption—Certain Lines of Consolidated Rail Corporation, Finance Docket No. 32537 et al. (ICC served Jan. 12, 1996), slip op. at 5 (where an initial equity contribution was given in return for stock and the proceeds of an independent loan, the ICC stated that “. . . the provision by the parent company of start-up capital is not determinative of the issue of whether the newly formed subsidiary is responsible for its own operating profits and losses . . .”); South Kansas and Oklahoma Railroad, Inc.—Acquisition and Operation Exemption—The Atchison, Topeka and Santa Fe Railway Company—Petition to Revoke, Finance Docket No. 31802 (Sub-No. 1) (ICC served Nov. 27, 1992) (South Kansas), slip op. at 5 (footnote omitted) (“We have consistently held that loan guarantees and equity contributions by a parent company to a subsidiary do not render the subsidiary the alter ego of the parent.”); and New England Central Railroad, Inc.—Acquisition and Operation Exemption—Lines Between East Alburg, VT and New London, CT, Finance Docket No. 32432 (ICC served Dec. 9, 1994) (New England), aff’d sub nom. Brotherhood of R.R. Signalmen v. I.C.C., 63 F.3d 638 (7th Cir. 1995), reh’g denied Sept. 22, 1995, slip op. at 25-26, n.44 (“A parent’s guarantee of the financial obligation of the subsidiary to the seller is indeed common. It is not evidence of financial dependence if it is shown . . . that the parent is not providing any other financial guarantees.”)

acquiring noncarrier subsidiary had to assume full responsibility for its operating decisions, profits, debts, and risk of loss.⁸ The parent could not subsidize the new subsidiary or accept the financial risk for the ongoing enterprise and the role of the corporate parent could not extend beyond being a mere investor. Wheeling, slip op. at 5-7; New England, slip op. at 26; and Willamette.

Here, although we find this to be a closer call than in other similar cases, the facts indicate that the two entities have the requisite independence. As we found in Stay Decision, slip op. at 11, IC&E has indicated that it will operate with its own locomotives, cars and employees, have its own operating management, hold out to provide service in its own name, and be responsible for the risks and financial obligations arising from its operations. And, although there will be some overlap during the start-up phase, over the long haul, it appears that each company will be responsible for its own financial affairs.

CLO contends that DME's investment in IC&E goes beyond permissible start-up financing because DME's obligation includes a revolving credit facility and because both entities have pledged all of their assets to secure the obligations of the other. However, we do not believe that the circumstances call for a finding of financial interdependence here. IC&E indicates that its obligation for DME debt was necessary to obtain financing for the IMRL acquisition and that it will not become effective unless the Board approves DME's common control application and the control transaction is consummated. IC&E also states that its contingent guarantee extends only to the specific obligations of DME under the recent financing transaction and that IC&E is in no way responsible for any unrelated liabilities of DME. We have previously found that, notwithstanding the presence of capital loans and cross-collateralization of debt between the parent corporation and its new affiliate, the affiliate was sufficiently independent financially from its parent. Mountain Laurel, slip op. at 15-17 (parent's loan to the subsidiary to pay for post-closing track rehabilitation found not to make the noncarrier affiliate the alter ego of its parent). We recognize that the DME-IC&E financial arrangements, including the parties' revolving credit facility and cross-collateralization of debt, present a closer case for financial interdependence. But, notwithstanding IC&E's financial commitments with its parent corporation with respect to the start-up of the operations — which were necessary to get the transaction off of the ground — IC&E has shown that, on a going-forward basis, the two companies are and will continue to be financially independent. Indeed, IC&E's responsibility for DME's affairs is limited to transaction-related liabilities of DME.

⁸ See Wheeling Acquisition Corporation—Acquisition and Operation Exemption—Lines of Norfolk and Western Railway Company et al., Finance Docket No. 31591 et al. (ICC served Dec. 28, 1990) (Wheeling), slip op. at 5-7; Willamette, slip op. at 9.

Moreover, IC&E has shown that it is solely responsible for its day-to-day operations and resulting profits or losses.⁹ Although CLO contends that DME has created an integrated personnel scheme, IC&E refutes this claim by showing that the two work forces have different seniority rosters, rates of pay and benefits packages. IC&E indicates that it is responsible for its own accounts, including employee wages and benefits, lease payments on its cars and locomotives, cost of material and supplies, including fuel, trackage rights payments, joint facility fees, office rent, real estate taxes, utility bills, and car hire expenses. We find that IC&E has established that DME is not exposed to the risks, liabilities, or obligations involved in IC&E's daily operation of its rail system. Furthermore, IC&E has assured us that, in the event of its default on those obligations, creditors could not look to DME for payment, and no party has made a serious argument to the contrary. For these reasons, IC&E has established that it is sufficiently independent financially of its parent DME.

With regard to AEC, it argues that the notice of exemption contained false and misleading information because IC&E has in fact been unable to reach a deal with Metra as to routings into Chicago. But IC&E did not say that it had a deal with Metra; all that IC&E meant to do through its reference to Metra was explain how it intended to make its service through Chicago work. If it turns out that it is unable to work things out with Metra — and we understand that it is making progress in working out an arrangement with Metra — or with other carriers in the Chicago area, then the new routings of PRB coal that apparently concern AEC will not materialize. AEC has simply presented no basis for revocation.

Finally, as we have previously noted, there is no allegation that rail employees will be adversely affected by IC&E's acquisition. IC&E has represented that IMRL employees would, on the whole, benefit under its ownership and that virtually all interested, full-time IMRL employees have been offered positions at comparable or higher pay levels. IC&E states that it will also provide a number of other employee benefits. In addition, there is no claim that IC&E has failed to adhere to its representations to employees. In short, for the reasons discussed above and in Stay Decision, we find no basis for granting the petitions to revoke the exemption.

It is ordered:

1. IC&E's request for leave to late-file its reply is granted.

⁹ See South Kansas, slip op. at 3 (“Indicia of independence include: whether the new entity was formed for legitimate and substantial business reasons unrelated to the labor issue; whether the new entity has its own employees, management and equipment, publishes its own tariffs and operates under its own name; and whether it is responsible for its own financial and contractual obligations.”)

2. The petitions to revoke the exemption are denied.
3. This decision is effective on its service date.

By the Board, Chairman Nober, Vice Chairman Burkes, and Commissioner Morgan.

Vernon A. Williams
Secretary